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CALIFORNIA LEGISLATURE—2001–02 REGULAR SESSION

ASSEMBLY BILL

No. 278

Introduced by Assembly Members Cohn and Zettel

(Principal coauthor: Assembly Member Nakano)

(Coauthors: Assembly Members Alquist, Briggs, Canciamilla, Diaz, Koretz, Nation, Robert Pacheco, Rod Pacheco, Richman, Runner, Strickland, and Wyman)

(Coauthors: Senators Costa, Figueroa, and McPherson)

February 16, 2001

An act to amend Sections ~~17053.49~~ 6377, 17053.49, and 23649 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 278, as amended, Cohn. Personal income and bank and corporation taxes: credit: manufacturer's investment.

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property and provides various exemptions from the taxes imposed by that law. That law provides an exemption from those taxes for the gross receipts from the sale of, and the storage, use, or other consumption of, tangible personal property, as defined, purchased for use by a qualified person, as defined, primarily in any state of manufacturing, processing, refining, fabricating, or recycling

of property, and introduced into the process, as specified. That law also provides that this exemption will cease to be operative on January 1, 2001, or on January 1 of the earliest year thereafter, if total employment, as defined, in California does not exceed by 100,000 jobs the total employment in California on January 1, 1994.

This bill would extend the date on which this exemption will cease to be operative to January 1, 2008, or January 1 of the earliest year thereafter, if total employment, as defined, in California does not exceed by 100,000 jobs the total employment in California on January 1, 1994.

The Personal Income Tax Law and the Bank and Corporation Tax Law authorize various credits against the taxes imposed by those laws, including a credit against taxes imposed by those laws in an amount equal to 6% of the amount paid or incurred during the taxable year for qualified property, as defined, that is placed in service in this state. Existing law provides that this credit will cease to be operative on January 1, 2001, or on January 1 of the earliest year thereafter, if total employment, as defined, in California does not exceed by 100,000 jobs the total employment in California on January 1, 1994.

This bill would increase this credit to 7% of the amount paid or incurred during the taxable year for qualified property, as defined, that is placed in service in this state. This bill also would extend the date on which this credit will cease to be operative to January 1, 2008, or January 1 of the earliest year thereafter, if total employment, as defined, in California does not exceed by 100,000 jobs the total employment in California on January 1, 1994.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. *Section 6377 of the Revenue and Taxation Code*
2 *is amended to read:*

3 6377. (a) There are exempted from the taxes imposed by this
4 part the gross receipts from the sale of, and the storage, use, or
5 other consumption in this state of, any of the following:

6 (1) Tangible personal property purchased for use by a qualified
7 person to be used primarily in any stage of the manufacturing,
8 processing, refining, fabricating, or recycling of property,
9 beginning at the point any raw materials are received by the

1 qualified person and introduced into the process and ending at the
2 point at which the manufacturing, processing, refining,
3 fabricating, or recycling has altered property to its completed
4 form, including packaging, if required.

5 (2) Tangible personal property purchased for use by a qualified
6 person to be used primarily in research and development.

7 (3) Tangible personal property purchased for use by a qualified
8 person to be used primarily to maintain, repair, measure, or test any
9 property described in paragraph (1) or (2).

10 (4) Tangible personal property purchased for use by a
11 contractor purchasing that property either as an agent of a qualified
12 person or for the contractor's own account and subsequent resale
13 to a qualified person for use in the performance of a construction
14 contract for the qualified person who will use the tangible personal
15 property as an integral part of the manufacturing, processing,
16 refining, fabricating, or recycling process, or as a research or
17 storage facility for use in connection with the manufacturing
18 process.

19 This exemption shall not apply to any tangible personal
20 property that is used primarily in administration, general
21 management, or marketing.

22 (b) For purposes of this section:

23 (1) "Fabricating" means to make, build, create, produce, or
24 assemble components or property to work in a new or different
25 manner.

26 (2) "Manufacturing" means the activity of converting or
27 conditioning property by changing the form, composition, quality,
28 or character of the property for ultimate sale at retail or use in the
29 manufacturing of a product to be ultimately sold at retail.
30 Manufacturing includes any improvements to tangible personal
31 property that result in a greater service life or greater functionality
32 than that of the original property.

33 (3) "Primarily" means tangible personal property used 50
34 percent or more of the time in an activity described in subdivision
35 (a).

36 (4) "Process" means the period beginning at the point at which
37 any raw materials are received by the qualified taxpayer and
38 introduced into the manufacturing, processing, refining,
39 fabricating, or recycling activity of the qualified taxpayer and
40 ending at the point at which the manufacturing, processing,

1 refining, fabricating, or recycling activity of the qualified taxpayer
2 has altered tangible personal property to its completed form,
3 including packaging, if required. Raw materials shall be
4 considered to have been introduced into the process when the raw
5 materials are stored on the same premises where the qualified
6 taxpayer's manufacturing, processing, refining, or recycling
7 activity is conducted. Raw materials that are stored on premises
8 other than where the qualified taxpayer's manufacturing,
9 processing, refining, fabricating, or recycling activity is
10 conducted, shall not be considered to have been introduced into the
11 manufacturing, processing, refining, fabricating, or recycling
12 process.

13 (5) "Processing" means the physical application of the
14 materials and labor necessary to modify or change the
15 characteristics of property.

16 (6) "Qualified person" means any person that is both of the
17 following:

18 (A) A new trade or business. In determining whether a trade or
19 business activity qualifies as a new trade or business, the following
20 rules shall apply:

21 (i) In any case where a person purchases or otherwise acquires
22 all or any portion of the assets of an existing trade or business
23 (irrespective of the form of entity) that is doing business in this
24 state (within the meaning of Section 23101), the trade or business
25 thereafter conducted by that person (or any related person) shall
26 not be treated as a new business if the aggregate fair market value
27 of the acquired assets (including, real, personal, tangible, and
28 intangible property) used by that person (or any related person) in
29 the conduct of his or her trade or business exceed 20 percent of the
30 aggregate fair market value of the total assets of the trade or
31 business being conducted by the person (or any related person).
32 For purposes of this subparagraph only, the following rules shall
33 apply:

34 (I) The determination of the relative fair market values of the
35 acquired assets and the total assets shall be made as of the last day
36 of the month following the quarterly period in which the person (or
37 any related person) first uses any of the acquired trade or business
38 assets in his or her business activity.

39 (II) Any acquired assets that constituted property described in
40 Section 1221(1) of the Internal Revenue Code in the hands of the



1 transferor shall not be treated as assets acquired from an existing
2 trade or business, unless those assets also constitute property
3 described in Section 1221(1) of the Internal Revenue Code in the
4 hands of the acquiring person (or related person).

5 (ii) In any case where a person (or any related person) is
6 engaged in one or more trade or business activities in this state, or
7 has been engaged in one or more trade or business activities in this
8 state within the preceding 36 months (“prior trade or business
9 activity”), and thereafter commences an additional trade or
10 business activity in this state, the additional trade or business
11 activity shall only be treated as a new business if the additional
12 trade or business activity is classified under a different division of
13 the Standard Industrial Classification Manual published by the
14 United States Office of Management and Budget, 1987 edition,
15 than are any of the person’s (or any related person’s) current or
16 prior trade or business activities in this state.

17 (iii) In any case where a person, including all related persons,
18 is engaged in trade or business activities wholly outside of this
19 state and that person first commences doing business in this state
20 (within the meaning of Section 23101) after December 31, 1993
21 (other than by purchase or other acquisition described in clause
22 (i)), the trade or business activity shall be treated as a new business.

23 (iv) In any case where the legal form under which a trade or
24 business activity is being conducted is changed, the change in form
25 shall be disregarded and the determination of whether the trade or
26 business activity is a new business shall be made by treating the
27 person as having purchased or otherwise acquired all or any
28 portion of the assets of an existing trade or business under the rules
29 of clause (i).

30 (v) “Related person” means any person that is related to that
31 person under either Section 267 or 318 of the Internal Revenue
32 Code.

33 (vi) “Acquire” includes any gift, inheritance, transfer incident
34 to divorce, or any other transfer, whether or not for consideration.

35 (B) Engaged in those lines of business described in Codes 2011
36 to 3999, inclusive, of the Standard Industrial Classification
37 Manual published by the United States Office of Management and
38 Budget, 1987 edition.

(7) Notwithstanding paragraph (6), “qualified person” shall not include any person who has conducted business activities in a new trade or business for three or more years.

(8) “Refining” means the process of converting a natural resource to an intermediate or finished product.

(9) “Research and development” means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) “Tangible personal property” does not include any of the following:

(A) Consumables with a normal useful life of less than one year, except as provided in subparagraph (E) of paragraph ~~(10)~~ (11).

(B) Furniture, inventory, equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing process.

(C) Any property for which a credit is claimed under either Section 17053.49 or 23649.

(11) “Tangible personal property” includes, but is not limited to, all of the following:

(A) Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures.

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party.

(C) Property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state.

(D) Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, or fabricating process, or that constitute a research or storage facility used during the manufacturing process. Buildings used solely for warehousing purposes after completion of the manufacturing process are not included.

1 (E) Fuels used or consumed in the manufacturing process.

2 (F) Property used in recycling.

3 (c) No exemption shall be allowed under this section unless the
4 purchaser furnishes the retailer with an exemption certificate,
5 completed in accordance with any instructions or regulations as
6 the board may prescribe, and the retailer subsequently furnishes
7 the board with a copy of the exemption certificate. The exemption
8 certificate shall contain the sales price of the machinery or
9 equipment that is exempt pursuant to subdivision (a).

10 (d) Notwithstanding any provision of the Bradley-Burns
11 Uniform Local Sales and Use Tax Law (Part 1.5 (commencing
12 with Section 7200)) or the Transactions and Use Tax Law (Part 1.6
13 (commencing with Section 7251)), the exemption established by
14 this section shall not apply with respect to any tax levied by a
15 county, city, or district pursuant to, or in accordance with, either
16 of those laws.

17 (e) (1) Notwithstanding subdivision (a), the exemption
18 provided by this section shall not apply to any sale or use of
19 property ~~which~~ *that*, within one year from the date of purchase, is
20 either removed from California or converted from an exempt use
21 under subdivision (a) to some other use not qualifying for the
22 exemption.

23 (2) Notwithstanding subdivision (a), on or after January 1,
24 1995, the exemption established by this section shall not apply
25 with respect to any tax levied pursuant to Sections 6051.2 and
26 6201.2, or pursuant to Section 35 of Article XIII of the California
27 Constitution.

28 (f) If a purchaser certifies in writing to the seller that the
29 property purchased without payment of the tax will be used in a
30 manner entitling the seller to regard the gross receipts from the sale
31 as exempt from the sales tax, and within one year from the date of
32 purchase, the purchaser (1) removes that property outside
33 California, (2) converts that property for use in a manner not
34 qualifying for the exemption, or (3) uses that property in a manner
35 not qualifying for the exemption, the purchaser shall be liable for
36 payment of sales tax, with applicable interest, as if the purchaser
37 were a retailer making a retail sale of the property at the time the
38 property is so removed, converted, or used, and the sales price of
39 the property to the purchaser shall be deemed the gross receipts
40 from that retail sale.

(g) (1) This section shall remain in effect until the date specified in paragraph (2), on which date this section shall cease to be operative, and as of that date is repealed.

(2) (A) This section shall cease to be operative on January 1, 2001, 2008, or on January 1 of the earliest year thereafter, if the total employment in this state, as determined by the Employment Development Department on the preceding January 1, does not exceed by 100,000 jobs the total employment in this state on January 1, 1994. The department shall report annually to the Legislature with respect to the determination required by the preceding sentence.

(B) For purposes of this paragraph, “total employment” means the total employment in the manufacturing sector, excluding employment in the aerospace sector.

(h) This section applies to leases of tangible personal property classified as “continuing sales” and “continuing purchases” in accordance with Sections 6006.1 and 6010.1. The exemption established by this section shall apply to the rentals payable pursuant to ~~such a lease~~ *these leases*, provided the lessee is a qualified person and the property is used in an activity described in subdivision (a). Rentals which meet the foregoing requirements are eligible for the exemption for a period of six years from the date of commencement of the lease. At the close of the six-year period from the date of commencement of the lease, lease receipts are subject to tax without exemption.

SEC. 2. Section 17053.49 of the Revenue and Taxation Code is amended to read:

17053.49. (a) (1) A qualified taxpayer shall be allowed a credit against the “net tax,” as defined in Section 17039, equal to 7 percent of the qualified cost of qualified property that is placed in service in this state.

(2) In the case of any qualified costs paid or incurred on or after January 1, 1994, and prior to the first taxable year of the qualified taxpayer beginning on or after January 1, 1995, the credit provided under paragraph (1) shall be claimed by the qualified taxpayer on the qualified taxpayer’s return for the first taxable year beginning on or after January 1, 1995. No credit shall be claimed under this section on a return filed for any taxable year commencing prior to the qualified taxpayer’s first taxable year beginning on or after January 1, 1995.

(b) (1) For purposes of this section, “qualified cost” means any cost that satisfies each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i). In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or prior to January 1, 1994, costs paid pursuant to that contract shall be subject to allocation as follows: contract costs shall be allocated to qualified property based on a ratio of costs actually paid prior to January 1, 1994, and total contract costs actually paid. “Cost paid” shall include, without limitation, contractual deposits and option payments. To the extent of costs allocated, whether or not currently deductible or depreciable for tax purposes, to a period prior to January 1, 1994, the cost shall be deemed allocated to property acquired before January 1, 1994, and is thus not a “qualified cost.”

(B) Except as provided in paragraph (3) of subdivision (d) and subparagraph (B) of paragraph (4) of subdivision (d), is an amount upon which the qualified taxpayer has paid, directly or indirectly, as a separately stated contract amount or as determined from the records of the qualified taxpayer, sales or use tax under Part 1 (commencing with Section 6001).

(C) Is an amount properly chargeable to the capital account of the qualified taxpayer.

(2) (A) For purposes of this subdivision, any contract entered into on or after January 1, 1994, that is a successor or replacement contract to a contract that was binding prior to January 1, 1994, shall be treated as a binding contract in existence prior to January 1, 1994.

(B) If a successor or replacement contract is entered into on or after January 1, 1994, and the subject of the successor or replacement contract relates both to amounts for the construction, reconstruction, or acquisition of qualified property described in the original binding contract and to costs for the construction, reconstruction, or acquisition of qualified property not described in the original binding contract, then the portion of those amounts

1 described in the successor or replacement contract that were not
2 described in the original binding contract shall not be treated as
3 costs paid or incurred pursuant to a binding contract in existence
4 on or prior to January 1, 1994, under subparagraph (A) of
5 paragraph (1).

6 (3) (A) For purposes of this section, an option contract in
7 existence prior to January 1, 1994, under which a qualified
8 taxpayer (or any other person related to the qualified taxpayer
9 within the meaning of Section 267 or 707 of the Internal Revenue
10 Code) had an option to acquire qualified property, shall be treated
11 as a binding contract under the rules in paragraph (2). For purposes
12 of this subparagraph, an option contract shall not include an option
13 under which the optionholder will forfeit an amount less than 10
14 percent of the fixed option price in the event the option is not
15 exercised.

16 (B) For purposes of this section, a contract shall be treated as
17 binding even if the contract is subject to a condition.

18 (4) For purposes of this subdivision, in the case of any qualified
19 taxpayer engaged in those lines of business described in Codes
20 7371 to 7373, inclusive, of the Standard Industrial Classification
21 (SIC) Manual published by the United States Office of
22 Management and Budget, 1987 edition, “the first taxable year
23 beginning on or after January 1, 1998,” shall be substituted for
24 “January 1, 1994,” in each place in which it appears.

25 (c) (1) For purposes of this section, “qualified taxpayer”
26 means any taxpayer engaged in those lines of business described
27 in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373,
28 inclusive, of the Standard Industrial Classification (SIC) Manual
29 published by the United States Office of Management and Budget,
30 1987 edition.

31 (2) In the case of any passthrough entity, the determination of
32 whether a taxpayer is a qualified taxpayer under this section shall
33 be made at the entity level and any credit under this section or
34 Section 23649 shall be allowed to the passthrough entity and
35 passed through to the partners or shareholders in accordance with
36 applicable provisions of Part 10 (commencing with Section
37 17001) or Part 11 (commencing with Section 23001). For purposes
38 of this paragraph, the term “passthrough entity” means any
39 partnership or S corporation.

1 (3) The Franchise Tax Board may prescribe regulations to carry
2 out the purposes of this section, including any regulations
3 necessary to prevent the avoidance of the effect of this section
4 through splitups, shell corporations, partnerships, tiered
5 ownership structures, sale-leaseback transactions, or otherwise.

6 (d) For purposes of this section, “qualified property” means
7 property that is described as any of the following:

8 (1) Tangible personal property that is defined in Section
9 1245(a) of the Internal Revenue Code for use by a qualified
10 taxpayer in those lines of business described in Codes 2011 to
11 3999, inclusive, of the Standard Industrial Classification (SIC)
12 Manual published by the United States Office of Management and
13 Budget, 1987 edition, that is primarily used for any of the
14 following:

15 (A) For the manufacturing, processing, refining, fabricating, or
16 recycling of property, beginning at the point at which any raw
17 materials are received by the qualified taxpayer and introduced
18 into the process and ending at the point at which the
19 manufacturing, processing, refining, fabricating, or recycling has
20 altered tangible personal property to its completed form, including
21 packaging, if required.

22 (B) In research and development.

23 (C) To maintain, repair, measure, or test any property described
24 in this paragraph.

25 (D) For pollution control that meets or exceeds standards
26 established by the state or by any local or regional governmental
27 agency within the state.

28 (E) For recycling.

29 (2) Computers and computer peripheral equipment, as defined
30 in Section 168(i)(2)(B) of the Internal Revenue Code, that is
31 tangible personal property as defined in Section 1245(a) of the
32 Internal Revenue Code for use by a qualified taxpayer in those
33 lines of business described in SIC Codes 7371 to 7373, inclusive,
34 of the SIC Manual, 1987 edition, that is primarily used to develop
35 or manufacture prepackaged software or custom software
36 prepared to the special order of the purchaser who uses the
37 program to produce and sell or license copies of the program as
38 prepackaged software.

(3) The value of any capitalized labor costs that are directly allocable to the construction or modification of property described in paragraph (1) or (2).

(4) In the case of any qualified taxpayer engaged in manufacturing activities described in SIC Code 357 or 367, those activities related to biotechnology described in SIC Code 8731, those activities related to biopharmaceutical establishments only that are described in SIC Codes 2833 to 2836, inclusive, those activities related to space vehicles and parts described in SIC Codes 3761 to 3769, inclusive, those activities related to space satellites and communications satellites and equipment described in SIC Codes 3663 and 3812 (but only with respect to “qualified property” that is placed in service on or after January 1, 1996), or those activities related to semiconductor equipment manufacturing described in SIC Code 3559 (but only with respect to “qualified property” that is placed in service on or after January 1, 1997), “qualified property” also includes the following:

(A) Special purpose buildings and foundations that are constructed or modified for use by the qualified taxpayer primarily in a manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(B) The value of any capitalized labor costs that are directly allocable to the construction or modification of special purpose buildings and foundations that are used primarily in the manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(C) (i) For purposes of this paragraph, “special purpose building and foundation” means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subparagraph (A) (“qualified purpose”).

(ii) A building is specifically designed and constructed or modified for a qualified purpose if it is not economical to design

1 and construct the building for the intended purpose and then use
2 the structure for a different purpose.

3 (iii) For purposes of clause (i) and clause (vi), a building is used
4 exclusively for a qualified purpose only if its use does not include
5 a use for which it was not specifically designed and constructed or
6 modified. Incidental use of a building for nonqualified purposes
7 does not preclude the building from being a special purpose
8 building. “Incidental use” means a use which is both related and
9 subordinate to the qualified purpose. It will be conclusively
10 presumed that a use is not subordinate if more than one-third of the
11 total usable volume of the building is devoted to a use which is not
12 a qualified purpose.

13 (iv) In the event that an entire building does not qualify as a
14 special purpose building, a taxpayer may establish that a portion
15 of a building, and the foundation immediately underlying the
16 portion, qualifies for treatment as a special purpose building and
17 foundation if the portion satisfies all of the definitional provisions
18 in this subparagraph.

19 (v) To the extent that a building is not a special purpose
20 building as defined above, but a portion of the building qualifies
21 for treatment as a special purpose building, then all equipment that
22 exclusively supports the qualified purpose occurring within that
23 portion and that would qualify as Internal Revenue Code Section
24 1245 property if it were not a fixture or affixed to the building shall
25 be treated as a cost of the portion of the building that qualifies for
26 treatment as a special purpose building.

27 (vi) Buildings and foundations that do not meet the definition
28 of a special purpose building and foundation set forth above
29 include, but are not limited to: buildings designed and constructed
30 or reconstructed principally to function as a general purpose
31 manufacturing, industrial, or commercial building; research
32 facilities that are used primarily prior to or after, or prior to and
33 after, the manufacturing process; or storage facilities that are used
34 primarily prior to or after, or prior to and after, completion of the
35 manufacturing process. A research facility shall not be considered
36 to be used primarily prior to or after, or prior to and after, the
37 manufacturing process if its purpose and use relate exclusively to
38 the development and regulatory approval of the manufacturing
39 process for specific biopharmaceutical products. A research
40 facility that is used primarily in connection with the discovery of



1 an organism from which a biopharmaceutical product or process
2 is developed does not meet the requirements of the preceding
3 sentence.

4 (5) Subject to the provisions in subparagraph (B) of paragraph
5 (1) of subdivision (b), qualified property also includes computer
6 software that is primarily used for those purposes set forth in
7 paragraph (1) or (2) of this subdivision.

8 (6) Qualified property does not include any of the following:

9 (A) Furniture.

10 (B) Facilities used for warehousing purposes after completion
11 of the manufacturing process.

12 (C) Inventory.

13 (D) Equipment used in the extraction process.

14 (E) Equipment used to store finished products that have
15 completed the manufacturing process.

16 (F) Any tangible personal property that is used in
17 administration, general management, or marketing.

18 (e) For purposes of this section:

19 (1) “Biopharmaceutical activities” means those activities that
20 use organisms or materials derived from organisms, and their
21 cellular, subcellular, or molecular components, in order to provide
22 pharmaceutical products for human or animal therapeutics and
23 diagnostics. Biopharmaceutical activities make use of living
24 organisms to make commercial products, as opposed to
25 pharmaceutical activities which make use of chemical compounds
26 to produce commercial products.

27 (2) “Fabricating” means to make, build, create, produce, or
28 assemble components or property to work in a new or different
29 manner.

30 (3) “Manufacturing” means the activity of converting or
31 conditioning property by changing the form, composition, quality,
32 or character of the property for ultimate sale at retail or use in the
33 manufacturing of a product to be ultimately sold at retail.
34 Manufacturing includes any improvements to tangible personal
35 property that result in a greater service life or greater functionality
36 than that of the original property.

37 (4) “Other biotechnology activities” means activities
38 consisting of the application of recombinant DNA technology to
39 produce commercial products, as well as activities regarding



1 pharmaceutical delivery systems designed to provide a measure of
2 control over the rate, duration, and site of pharmaceutical delivery.

3 (5) “Primarily” means tangible personal property used 50
4 percent or more of the time in an activity described in subdivision
5 (d).

6 (6) “Process” means the period beginning at the point at which
7 any raw materials are received by the qualified taxpayer and
8 introduced into the manufacturing, processing, refining,
9 fabricating, or recycling activity of the qualified taxpayer and
10 ending at the point at which the manufacturing, processing,
11 refining, fabricating, or recycling activity of the qualified taxpayer
12 has altered tangible personal property to its completed form,
13 including packaging, if required. Raw materials shall be
14 considered to have been introduced into the process when the raw
15 materials are stored on the same premises where the qualified
16 taxpayer’s manufacturing, processing, refining, or recycling
17 activity is conducted. Raw materials that are stored on premises
18 other than where the qualified taxpayer’s manufacturing,
19 processing, refining, fabricating, or recycling activity is
20 conducted, shall not be considered to have been introduced into the
21 manufacturing, processing, refining, fabricating, or recycling
22 process.

23 (7) “Processing” means the physical application of the
24 materials and labor necessary to modify or change the
25 characteristics of property.

26 (8) “Refining” means the process of converting a natural
27 resource to an intermediate or finished product.

28 (9) “Research and development” means those activities that
29 are described in Section 174 of the Internal Revenue Code or in any
30 regulations thereunder.

31 (10) “Small business” means a qualified taxpayer that meets
32 any of the following requirements during the taxable year for
33 which the credit is allowed:

34 (A) Has gross receipts of less than fifty million dollars
35 (\$50,000,000).

36 (B) Has net assets of less than fifty million dollars
37 (\$50,000,000).

38 (C) Has a total credit of less than one million dollars
39 (\$1,000,000).

1 (D) For taxable years beginning on or after January 1, 1997, is
2 engaged in biopharmaceutical activities or other biotechnology
3 activities that are described in Codes 2833 to 2836, inclusive, of
4 the Standard Industrial Classification (SIC) Manual published by
5 the United States Office of Management and Budget, 1987 edition,
6 and has not received regulatory approval for any product from the
7 United States Food and Drug Administration.

8 (f) The credit allowed under subdivision (a) shall apply to
9 qualified property that is acquired by or subject to lease by a
10 qualified taxpayer, subject to the following special rules:

11 (1) A lessor of qualified property, irrespective of whether the
12 lessor is a qualified taxpayer, shall not be allowed the credit
13 provided under subdivision (a) with respect to any qualified
14 property leased to another qualified taxpayer.

15 (2) For purposes of paragraphs (2) and (3) of subdivision (b),
16 “binding contract” shall include any lease agreement with respect
17 to the qualified property.

18 (3) (A) For purposes of determining the qualified cost paid or
19 incurred by a lessee in any leasing transaction that is not treated as
20 a sale under Part 1 (commencing with Section 6001), the following
21 rules shall apply:

22 (i) Except as provided by subparagraph (C) of this paragraph,
23 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)
24 shall not apply.

25 (ii) Except as provided in subparagraph (B) and clause (iii), the
26 “qualified cost” upon which the lessee shall compute the credit
27 provided under this section shall be equal to the original cost to the
28 lessor (within the meaning of Section 18031) of the qualified
29 property that is the subject of the lease.

30 (iii) Except as provided in clause (iv), the requirement of
31 subparagraph (B) of paragraph (1) of subdivision (b) shall be
32 treated as satisfied only if the lessor has made a timely election
33 under either Section 6094.1 or subdivision (d) of Section 6244 and
34 has paid sales tax reimbursement or use tax measured by the
35 purchase price of the qualified property (within the meaning of
36 paragraph (5) of subdivision (g) of Section 6006). For purposes of
37 this subdivision and clause (iv), the amount of original cost to the
38 lessor that may be taken into account under clause (ii) shall not
39 exceed the purchase price upon which sales tax reimbursement or

1 use tax has been paid under the preceding sentence or under clause
2 (iv).

3 (iv) With respect to leases entered into between January 1,
4 1994, and the effective date of this clause, the lessor may elect to
5 pay use tax measured by the purchase price of the property by
6 reporting and paying the tax with the return of the lessor for the
7 fourth calendar quarter of 1994. In computing the use tax under the
8 preceding sentence, a credit shall be allowed under Part 1
9 (commencing with Section 6001) for all sales or use tax previously
10 paid on the lease.

11 (B) For purposes of applying subparagraph (A) only, the
12 following special rules shall apply:

13 (i) The original cost to the lessor of the qualified property shall
14 be reduced by the amount of any original cost of that property that
15 was taken into account by any predecessor lessee in computing the
16 credit allowable under this section.

17 (ii) Clause (i) shall not apply in any case where the predecessor
18 lessee was required to recapture the credit provided under this
19 section pursuant to subdivision (g).

20 (iii) For purposes of this section only, in any case where a
21 successor lessor has acquired qualified property from a
22 predecessor lessor in a transaction not treated as a sale under Part
23 1 (commencing with Section 6001), the original cost to the
24 successor lessor of the qualified property shall be reduced by the
25 amount of the original cost of the qualified property that was taken
26 into account by any lessee of the predecessor lessor in computing
27 the credit allowable under this section.

28 (C) In determining the original cost of any qualified property
29 under this paragraph, only amounts paid or incurred by the lessor
30 on or after January 1, 1994, and prior to the date this section ceases
31 to be operative under paragraph (2) of subdivision (i), shall be
32 taken into account. In the case of any qualified property
33 constructed, reconstructed, or acquired by a lessor pursuant to a
34 binding contract in existence on or prior to January 1, 1994, the
35 allocation rule specified in subparagraph (A) of paragraph (1) of
36 subdivision (b) shall apply in determining the original cost to the
37 lessor of qualified property.

38 (D) Notwithstanding subparagraph (A), in the case of any
39 leasing transaction for which the lessee is allowed the credit under
40 this section and thereafter the lessee (or any party related to the

1 lessee within the meaning of Section 267 or 318 of the Internal
2 Revenue Code) acquires the qualified property from the lessor (or
3 any successor lessor) within one year from the date the qualified
4 property is first used by the lessee under the terms of the lease, the
5 lessee's (or related party's) acquisition of the qualified property
6 from the lessor (or successor lessor) shall be treated as a
7 disposition by the lessee of the qualified property that was subject
8 to the lease under subdivision (g).

9 (4) For purposes of determining the qualified cost paid or
10 incurred by a lessee in any leasing transaction that is treated as a
11 sale under Part 1 (commencing with Section 6001), the following
12 rules shall apply:

13 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall
14 be applied by substituting the term "purchase" for the term
15 "construction, reconstruction, or acquisition."

16 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall
17 apply.

18 (C) The requirement of subparagraph (B) of paragraph (1) of
19 subdivision (b) shall be treated as satisfied at the time that either
20 the lessor or the qualified taxpayer pays sales or use tax under Part
21 1 (commencing with Section 6001).

22 (5) (A) In the case of any leasing transaction described in
23 paragraph (3), the lessor shall provide a statement to the lessee
24 specifying the amount of the lessor's original cost of the qualified
25 property and the amount of that cost upon which a sales or use tax
26 was paid within 45 days after the close of the lessee's taxable year
27 in which the credit is allowable to the lessee under this section.

28 (B) The statement required under subparagraph (A) shall be
29 made available to the Franchise Tax Board upon request.

30 (6) For purposes of this subdivision, in the case of any qualified
31 taxpayer engaged in those lines of business described in Codes
32 7371 to 7373, inclusive, of the Standard Industrial Classification
33 (SIC) Manual published by the United States Office of
34 Management and Budget, 1987 edition, "the first taxable year
35 beginning on or after January 1, 1998," shall be substituted for
36 "January 1, 1994," in each place in which it appears. In addition,
37 "the effective date of this paragraph" shall be substituted for "the
38 effective date of this clause" and "fourth calendar quarter of
39 1998" shall be substituted for "fourth calendar quarter of 1994."

1 (g) No credit shall be allowed if the qualified property is
 2 removed from the state, is disposed of to an unrelated party, or is
 3 used for any purpose not qualifying for the credit provided in this
 4 section in the same taxable year in which the qualified property is
 5 first placed in service in this state. If any qualified property for
 6 which a credit is allowed pursuant to this section is thereafter
 7 removed from this state, disposed of to an unrelated party, or used
 8 for any purpose not qualifying for the credit provided in this
 9 section within one year from the date the qualified property is first
 10 placed in service in this state, the amount of the credit allowed by
 11 this section for that qualified property shall be recaptured by
 12 adding that credit amount to the net tax of the qualified taxpayer
 13 for the taxable year in which the qualified property is disposed of,
 14 removed, or put to an ineligible use.

15 (h) In the case where the credit allowed by this section exceeds
 16 the “net tax,” the excess may be carried over to reduce the “net
 17 tax” in the following year, and succeeding years as follows:

18 (1) Except as provided in paragraph (2), for the seven
 19 succeeding years if necessary, until the credit is exhausted.

20 (2) In the case of a small business, for the nine succeeding
 21 years, if necessary, until the credit is exhausted.

22 (i) (1) This section shall remain in effect until the date
 23 specified in paragraph (2), on which date this section shall cease
 24 to be operative, and as of that date is repealed.

25 (2) (A) This section shall cease to be operative on January 1,
 26 2008, or on January 1 of the earliest year thereafter, if the total
 27 employment in this state, as determined by the Employment
 28 Development Department on the preceding January 1, does not
 29 exceed by 100,000 jobs the total employment in this state on
 30 January 1, 1994. The department shall report to the Legislature
 31 annually with respect to the determination required by the
 32 preceding sentence.

33 (B) For purposes of this paragraph, “total employment” means
 34 the total employment in the manufacturing sector, excluding
 35 employment in the aerospace sector.

36 (j) The amendments made by Chapter 954 of the Statutes of
 37 1996 shall be operative for taxable years beginning on or after
 38 January 1, 1997, except as provided in paragraph (3) of
 39 subdivision (d).

(k) The amendments made by Chapter 323 of the Statutes of 1998 shall be operative for taxable years beginning on or after January 1, 1998.

(l) The amendments made to subdivision (a) by the act adding this subdivision shall be operative for taxable years beginning on or after January 1, 2001.

~~SEC. 2.—~~

SEC. 3. Section 23649 of the Revenue and Taxation Code, as amended by Section 88 of Chapter 862 of the Statutes of 2000, is amended to read:

23649. (a) (1) A qualified taxpayer shall be allowed a credit against the “tax,” as defined in Section 23036, equal to 7 percent of the qualified cost of qualified property that is placed in service in this state.

(2) In the case of any qualified costs paid or incurred on or after January 1, 1994, and prior to the first taxable year of the qualified taxpayer beginning on or after January 1, 1995, the credit provided under paragraph (1) shall be claimed by the qualified taxpayer on the qualified taxpayer’s return for the first taxable year beginning on or after January 1, 1995. No credit shall be claimed under this section on a return filed for any taxable year commencing prior to the qualified taxpayer’s first taxable year beginning on or after January 1, 1995.

(b) (1) For purposes of this section, “qualified cost” means any cost that satisfies each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i). In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or prior to January 1, 1994, costs paid pursuant to that contract shall be subject to allocation as follows: contract costs shall be allocated to qualified property based on a ratio of costs actually paid prior to January 1, 1994, and total contract costs actually paid. “Cost paid” shall include, without limitation, contractual deposits and option payments. To the extent of cost allocated, whether or not currently

1 deductible or depreciable for tax purposes, to a period prior to
2 January 1, 1994, the cost shall be deemed allocated to property
3 acquired before January 1, 1994, and is thus not a “qualified cost.”

4 (B) Except as provided in paragraph (3) of subdivision (d) and
5 subparagraph (B) of paragraph (4) of subdivision (d), is an amount
6 upon which the qualified taxpayer has paid, directly or indirectly
7 as a separately stated contract amount or as determined from the
8 records of the qualified taxpayer, sales or use tax under Part 1
9 (commencing with Section 6001).

10 (C) Is an amount properly chargeable to the capital account of
11 the qualified taxpayer.

12 (2) (A) For purposes of this subdivision, any contract entered
13 into on or after January 1, 1994, that is a successor or replacement
14 contract to a contract that was binding prior to January 1, 1994,
15 shall be treated as a binding contract in existence prior to January
16 1, 1994.

17 (B) If a successor or replacement contract is entered into on or
18 after January 1, 1994, and the subject of the successor or
19 replacement contract relates both to amounts for the construction,
20 reconstruction, or acquisition of qualified property described in
21 the original binding contract and to costs for the construction,
22 reconstruction, or acquisition of qualified property not described
23 in the original binding contract, then the portion of those amounts
24 described in the successor or replacement contract that were not
25 described in the original binding contract shall not be treated as
26 costs paid or incurred pursuant to a binding contract in existence
27 on or prior to January 1, 1994, under subparagraph (A) of
28 paragraph (1).

29 (3) (A) For purposes of this section, an option contract in
30 existence prior to January 1, 1994, under which a qualified
31 taxpayer (or any other person related to the qualified taxpayer
32 within the meaning of Section 267 or 707 of the Internal Revenue
33 Code) had an option to acquire qualified property, shall be treated
34 as a binding contract under the rules in paragraph (2). For purposes
35 of this subparagraph, an option contract shall not include an option
36 under which the optionholder will forfeit an amount less than 10
37 percent of the fixed option price in the event the option is not
38 exercised.

39 (B) For purposes of this section, a contract shall be treated as
40 binding even if the contract is subject to a condition.

(4) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, “the first taxable year beginning on or after January 1, 1998,” shall be substituted for “January 1, 1994,” in each place in which it appears.

(c) (1) For purposes of this section, “qualified taxpayer” means any taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer shall be made at the entity level and any credit under this section or Section 17053.49 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or S corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) For purposes of this section, “qualified property” means property that is described as either of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the

1 manufacturing, processing, refining, fabricating, or recycling has
2 altered tangible personal property to its completed form, including
3 packaging, if required.

4 (B) In research and development.

5 (C) To maintain, repair, measure, or test any property described
6 in this paragraph.

7 (D) For pollution control that meets or exceeds standards
8 established by the state or by any local or regional governmental
9 agency within the state.

10 (E) For recycling.

11 (2) Computers and computer peripheral equipment, as defined
12 in Section 168(i)(2)(B) of the Internal Revenue Code, that is
13 tangible personal property as defined in Section 1245(a) of the
14 Internal Revenue Code for use by a qualified taxpayer in those
15 lines of business described in SIC Codes 7371 to 7373, inclusive,
16 of the SIC Manual, 1987 edition, that is primarily used to develop
17 or manufacture prepackaged software or custom software
18 prepared to the special order of the purchaser who uses the
19 program to produce and sell or license copies of the program as
20 prepackaged software.

21 (3) The value of any capitalized labor costs that are directly
22 allocable to the construction or modification of property described
23 in paragraph (1) or (2).

24 (4) In the case of any qualified taxpayer engaged in
25 manufacturing activities described in SIC Code 357 or 367, those
26 activities related to biotechnology described in SIC Code 8731,
27 those activities related to biopharmaceutical establishments only
28 that are described in SIC Codes 2833 to 2836, inclusive, those
29 activities related to space vehicles and parts described in SIC
30 Codes 3761 to 3769, inclusive, those activities related to space
31 satellites and communications satellites and equipment described
32 in SIC Codes 3663 and 3812 (but only with respect to “qualified
33 property” that is placed in service on or after January 1, 1996), or
34 those activities related to semiconductor equipment
35 manufacturing described in SIC Code 3559 (but only with respect
36 to “qualified property” that is placed in service on or after January
37 1, 1997), “qualified property” also includes the following:

38 (A) Special purpose buildings and foundations that are
39 constructed or modified for use by the qualified taxpayer primarily
40 in a manufacturing, processing, refining, or fabricating process, or

1 as a research or storage facility primarily used in connection with
2 a manufacturing process.

3 (B) The value of any capitalized labor costs that are directly
4 allocable to the construction or modification of special purpose
5 buildings and foundations that are used primarily in the
6 manufacturing, processing, refining, or fabricating process, or as
7 a research or storage facility primarily used in connection with a
8 manufacturing process.

9 (C) (i) For purposes of this paragraph, “special purpose
10 building and foundation” means only a building and the
11 foundation immediately underlying the building that is
12 specifically designed and constructed or reconstructed for the
13 installation, operation, and use of specific machinery and
14 equipment with a special purpose, which machinery and
15 equipment, after installation, will become affixed to or a fixture of
16 the real property, and the construction or reconstruction of which
17 is specifically designed and used exclusively for the specified
18 purposes as set forth in subparagraph (A) (“qualified purpose”).

19 (ii) A building is specifically designed and constructed or
20 modified for a qualified purpose if it is not economical to design
21 and construct the building for the intended purpose and then use
22 the structure for a different purpose.

23 (iii) For purposes of clause (i) and clause (vi), a building is used
24 exclusively for a qualified purpose only if its use does not include
25 a use for which it was not specifically designed and constructed or
26 modified. Incidental use of a building for nonqualified purposes
27 does not preclude the building from being a special purpose
28 building. “Incidental use” means a use which is both related and
29 subordinate to the qualified purpose. It will be conclusively
30 presumed that a use is not subordinate if more than one-third of the
31 total usable volume of the building is devoted to a use which is not
32 a qualified purpose.

33 (iv) In the event that an entire building does not qualify as a
34 special purpose building, a taxpayer may establish that a portion
35 of a building, and the foundation immediately underlying the
36 portion, qualifies for treatment as a special purpose building and
37 foundation if the portion satisfies all of the definitional provisions
38 in this subparagraph.

39 (v) To the extent that a building is not a special purpose
40 building as defined above, but a portion of the building qualifies



for treatment as a special purpose building, then all equipment that exclusively supports the qualified purpose occurring within that portion and that would qualify as Internal Revenue Code Section 1245 property if it were not a fixture or affixed to the building shall be treated as a cost of the portion of the building that qualifies for treatment as a special purpose building.

(vi) Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to: buildings designed and constructed or reconstructed principally to function as a general purpose manufacturing, industrial, or commercial building; research facilities that are used primarily prior to or after, or prior to and after, the manufacturing process; or storage facilities that are used primarily prior to or after, or prior to and after, completion of the manufacturing process. A research facility shall not be considered to be used primarily prior to or after, or prior to and after, the manufacturing process if its purpose and use relate exclusively to the development and regulatory approval of the manufacturing process for specific biopharmaceutical products. A research facility that is used primarily in connection with the discovery of an organism from which a biopharmaceutical product or process is developed does not meet the requirements of the preceding sentence.

(5) Subject to the provisions in subparagraph (B) of paragraph (1) of subdivision (b), qualified property also includes computer software that is primarily used for those purposes set forth in paragraph (1) or (2) of this subdivision.

(6) Qualified property does not include any of the following:

- (A) Furniture.
- (B) Facilities used for warehousing purposes after completion of the manufacturing process.
- (C) Inventory.
- (D) Equipment used in the extraction process.
- (E) Equipment used to store finished products that have completed the manufacturing process.
- (F) Any tangible personal property that is used in administration, general management, or marketing.

(e) For purposes of this section:

- (1) “Biopharmaceutical activities” means those activities that use organisms or materials derived from organisms, and their

1 cellular, subcellular, or molecular components, in order to provide
2 pharmaceutical products for human or animal therapeutics and
3 diagnostics. Biopharmaceutical activities make use of living
4 organisms to make commercial products, as opposed to
5 pharmaceutical activities which make use of chemical compounds
6 to produce commercial products.

7 (2) “Fabricating” means to make, build, create, produce, or
8 assemble components or property to work in a new or different
9 manner.

10 (3) “Manufacturing” means the activity of converting or
11 conditioning property by changing the form, composition, quality,
12 or character of the property for ultimate sale at retail or use in the
13 manufacturing of a product to be ultimately sold at retail.
14 Manufacturing includes any improvements to tangible personal
15 property that result in a greater service life or greater functionality
16 than that of the original property.

17 (4) “Other biotechnology activities” means activities
18 consisting of the application of recombinant DNA technology to
19 produce commercial products, as well as activities regarding
20 pharmaceutical delivery systems designed to provide a measure of
21 control over the rate, duration, and site of pharmaceutical delivery.

22 (5) “Primarily” means tangible personal property used 50
23 percent or more of the time in an activity described in subdivision
24 (d).

25 (6) “Process” means the period beginning at the point at which
26 any raw materials are received by the qualified taxpayer and
27 introduced into the manufacturing, processing, refining,
28 fabricating, or recycling activity of the qualified person and
29 ending at the point at which the manufacturing, processing,
30 refining, fabricating, or recycling activity of the qualified taxpayer
31 has altered tangible personal property to its completed form,
32 including packaging, if required. Raw materials shall be
33 considered to have been introduced into the process when the raw
34 materials are stored on the same premises where the qualified
35 taxpayer’s manufacturing, processing, refining, fabricating, or
36 recycling activity is conducted. Raw materials that are stored on
37 premises other than where the qualified taxpayer’s manufacturing,
38 processing, refining, fabricating, or recycling activity is
39 conducted, shall not be considered to have been introduced into the

1 manufacturing, processing, refining, fabricating, or recycling
2 process.

3 (7) “Processing” means the physical application of the
4 materials and labor necessary to modify or change the
5 characteristics of property.

6 (8) “Refining” means the process of converting a natural
7 resource to an intermediate or finished product.

8 (9) “Research and development” means those activities that
9 are described in Section 174 of the Internal Revenue Code or in any
10 regulations thereunder.

11 (10) “Small business” means a qualified taxpayer that meets
12 any of the following requirements during the taxable year for
13 which the credit is allowed:

14 (A) Has gross receipts of less than fifty million dollars
15 (\$50,000,000).

16 (B) Has net assets of less than fifty million dollars
17 (\$50,000,000).

18 (C) Has a total credit of less than one million dollars
19 (\$1,000,000).

20 (D) For taxable years beginning on or after January 1, 1997, is
21 engaged in biopharmaceutical activities or other biotechnology
22 activities that are described in Codes 2833 to 2836, inclusive, of
23 the Standard Industrial Classification (SIC) Manual published by
24 the United States Office of Management and Budget, 1987 edition,
25 and has not received regulatory approval for any product from the
26 United States Food and Drug Administration.

27 (f) The credit allowed under subdivision (a) shall apply to
28 qualified property that is acquired by or subject to lease by a
29 qualified taxpayer, subject to the following special rules:

30 (1) A lessor of qualified property, irrespective of whether the
31 lessor is a qualified taxpayer, shall not be allowed the credit
32 provided under subdivision (a) with respect to any qualified
33 property leased to another qualified taxpayer.

34 (2) For purposes of paragraphs (2) and (3) of subdivision (b),
35 “binding contract” shall include any lease agreement with respect
36 to the qualified property.

37 (3) (A) For purposes of determining the qualified cost paid or
38 incurred by a lessee in any leasing transaction that is not treated as
39 a sale under Part 1 (commencing with Section 6001), the following
40 rules shall apply:

1 (i) Except as provided by subparagraph (C) of this paragraph,
2 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)
3 shall not apply.

4 (ii) Except as provided in subparagraph (B) and clause (iii), the
5 “qualified cost” upon which the lessee shall compute the credit
6 provided under this section shall be equal to the original cost to the
7 lessor (within the meaning of Section 24912) of the qualified
8 property that is the subject of the lease.

9 (iii) Except as provided in clause (iv), the requirement of
10 subparagraph (B) of paragraph (1) of subdivision (b) shall be
11 treated as satisfied only if the lessor has made a timely election
12 under either Section 6094.1 or subdivision (d) of Section 6244 and
13 has paid sales tax reimbursement or use tax measured by the
14 purchase price of the qualified property (within the meaning of
15 paragraph (5) of subdivision (g) of Section 6006). For purposes of
16 this subdivision and clause (iv), the amount of original cost to the
17 lessor that may be taken into account under clause (ii) shall not
18 exceed the purchase price upon which sales tax reimbursement or
19 use tax has been paid under the preceding sentence or under clause
20 (iv).

21 (iv) With respect to leases entered into between January 1,
22 1994, and the effective date of this clause, the lessor may elect to
23 pay use tax measured by the purchase price of the property by
24 reporting and paying the tax with the return of the lessor for the
25 fourth calendar quarter of 1994. In computing the use tax under the
26 preceding sentence, a credit shall be allowed under Part 1
27 (commencing with Section 6001) for all sales or use tax previously
28 paid on the lease.

29 (B) For purposes of applying subparagraph (A) only, the
30 following special rules shall apply:

31 (i) The original cost to the lessor of the qualified property shall
32 be reduced by the amount of any original cost of that property that
33 was taken into account by any predecessor lessee in computing the
34 credit allowable under this section.

35 (ii) Clause (i) shall not apply in any case where the predecessor
36 lessee was required to recapture the credit provided under this
37 section pursuant to subdivision (g).

38 (iii) For purposes of this section only, in any case where a
39 successor lessor has acquired qualified property from a
40 predecessor lessor in a transaction not treated as a sale under Part

1 1 (commencing with Section 6001), the original cost to the
2 successor lessor of the qualified property shall be reduced by the
3 amount of the original cost of the qualified property that was taken
4 into account by any lessee of the predecessor lessor in computing
5 the credit allowable under this section.

6 (C) In determining the original cost of any qualified property
7 under this paragraph, only amounts paid or incurred by the lessor
8 on or after January 1, 1994, and prior to the date this section ceases
9 to be operative under paragraph (2) of subdivision (i), shall be
10 taken into account. In the case of any qualified property
11 constructed, reconstructed, or acquired by a lessor pursuant to a
12 binding contract in existence on or prior to January 1, 1994, the
13 allocation rule specified in subparagraph (A) of paragraph (1) of
14 subdivision (b) shall apply in determining the original cost to the
15 lessor of qualified property.

16 (D) Notwithstanding subparagraph (A), in the case of any
17 leasing transaction for which the lessee is allowed the credit under
18 this section and thereafter the lessee (or any party related to the
19 lessee within the meaning of Section 267 or 318 of the Internal
20 Revenue Code) acquires the qualified property from the lessor (or
21 any successor lessor) within one year from the date the qualified
22 property is first used by the lessee under the terms of the lease, the
23 lessee's (or related party's) acquisition of the qualified property
24 from the lessor (or successor lessor) shall be treated as a
25 disposition by the lessee of the qualified property that was subject
26 to the lease under subdivision (g).

27 (4) For purposes of determining the qualified cost paid or
28 incurred by a lessee in any leasing transaction that is treated as a
29 sale under Part 1 (commencing with Section 6001), the following
30 rules shall apply:

31 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall
32 be applied by substituting the term "purchase" for the term
33 "construction, reconstruction, or acquisition."

34 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall
35 apply.

36 (C) The requirement of subparagraph (B) of paragraph (1) of
37 subdivision (b) shall be treated as satisfied at the time that either
38 the lessor or the qualified taxpayer pays sales or use tax under Part
39 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's taxable year in which the credit is allowable to the lessee under this section.

(B) The statement required under subparagraph (A) shall be made available to the Franchise Tax Board upon request.

(6) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, "the first taxable year beginning on or after January 1, 1998," shall be substituted for "January 1, 1994," in each place in which it appears. In addition, "the effective date of this paragraph" shall be substituted for "the effective date of this clause" and "fourth calendar quarter of 1998" shall be substituted for "fourth calendar quarter of 1994."

(g) No credit shall be allowed if the qualified property is removed from the state, is disposed of to an unrelated party, or is used for any purpose not qualifying for the credit provided in this section in the same taxable year in which the qualified property is first placed in service in this state. If any qualified property for which a credit is allowed pursuant to this section is thereafter removed from this state, disposed of to an unrelated party, or used for any purpose not qualifying for the credit provided in this section within one year from the date the qualified property is first placed in service in this state, the amount of the credit allowed by this section for that qualified property shall be recaptured by adding that credit amount to the net tax of the qualified taxpayer for the taxable year in which the qualified property is disposed of, removed, or put to an ineligible use.

(h) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years as follows:

(1) Except as provided in paragraph (2), for the seven succeeding years if necessary, until the credit is exhausted.

(2) In the case of a small business, for the nine succeeding years, if necessary, until the credit is exhausted.

1 (i) (1) This section shall remain in effect until the date
2 specified in paragraph (2) on which date this section shall cease to
3 be operative, and as of that date is repealed.

4 (2) (A) This section shall cease to be operative on January 1,
5 2008, or on January 1 of the earliest year thereafter, if the total
6 employment in this state, as determined by the Employment
7 Development Department on the preceding January 1, does not
8 exceed by 100,000 jobs the total employment in this state on
9 January 1, 1994. The department shall report to the Legislature
10 annually with respect to the determination required by the
11 preceding sentence.

12 (B) For purposes of this paragraph, "total employment" means
13 the total employment in the manufacturing sector, excluding
14 employment in the aerospace sector.

15 (j) The amendments made by Chapter 954 of the Statutes of
16 1996 shall be operative for taxable years beginning on or after
17 January 1, 1997, except as provided in paragraph (3) of
18 subdivision (d).

19 (k) The amendments made by Chapter 323 of the Statutes of
20 1998 shall be operative for taxable years beginning on or after
21 January 1, 1998.

22 (l) The amendments made to subdivision (a) by the act adding
23 this subdivision shall be operative for taxable years beginning on
24 or after January 1, 2001.

25 ~~SEC. 3.—~~

26 *SEC. 4.* This act provides for a tax levy within the meaning
27 of Article IV of the Constitution and shall go into immediate
28 effect.